Letter of the President of PKN ORLEN Management Board

Dear Sir or Madam, dear Shareholders,

The previous year witnessed an extremely changeable macroeconomic situation, which significantly affected the business and final financial result of the ORLEN Group. Because of the global economic crisis, crude oil prices plummeted, and Polish currency dynamic devaluation, which were the major factors influencing our financial results in the fourth quarter of the previous year.

Never in the history of the company had we been confronted with such rapid deterioration of external conditions whose effects could not be efficiently levelled off.

Last year results were very negatively influenced by macroeconomic environment, namely inventory valuation amounting to PLN 1.8 bn. Additionally, due to deteriorating economic condition and stock exchange capitalisation level remaining below net asset value for several months, we made a write-down of financial assets amounting to PLN 2.5 bn, based on the tests carried out, according to IAS 36 “Impairment of Assets”.

As a result of the adjustments made, we reported negative operating result at the level of PLN 1.6 bn. Even though EBITDA amounted to PLN 888 mn, the Group reported negative consolidated net result of PLN - 2.5 bn.
However, the Group maintained its stable financial position, which is proved by an over 80% increase in operating cash flow, amounting to PLN 3.6 bn at the end of 2008.

Last year, seven refineries owned by PKN ORLEN Capital Group processed 28 mn tonnes of crude oil. It is worth mentioning that we restored full processing capacities in Mažeikių Nafta refinery and significantly increased the Capital Group production of diesel, which is the most demanded product on the market.

Due to full availability of production installations in all PKN ORLEN refineries, we managed to react flexibly in situations of dramatic limitation of petrochemical production in the second half of 2008.

Moreover, last year we tested oil processing using methods alternative to REBCO in our refineries in Płock and Mažeikiu Nafta. This way, we obtained full knowledge of technological possibilities with respect to raw material diversification. We practically applied that knowledge in the Group Polish refineries, processing oil types: Fortis, Brent, Gulfaks, Oseberg, Ekofisk, Statfjord, Ukraine, Kazakhstan, Azeri and Polish oil: Dębno and Zielonogórska. The effects of our tests proved a real possibility of diversifying raw material supply sources, which is particularly important in circumstances requiring processing flexibility at unchanged economics, like at times of prolonged overhaul.

Last year, we reported very good effects in the retail sector - our fuel station network in CEE achieved an over 12% sales increase in quantity. At the same time, we started up 107 new fuel stations, 76 of them franchised. We implemented modernisation, rebranding and reconstruction processes in 225 fuel stations. We maintained consequent management of product categories and fuel services, and we launched a new catering service – STOP Cafe – on ORLEN stations. Thanks to our attractive offer on the Polish, German and Czech market, we increased our share in the retail market.

Our wholesale results should also be emphasised: we sold 24% more fuel compared to 2007. More than half of the fuels we offer constitute diesel fuels, whose sales went up by 24% as well. The highest demand dynamics was reported in the aviation fuel sector, whose sales in 2008 exceeded the volume of the previous year by appr. 54% percent. Moreover, we achieved satisfactory results in non-fuel product wholesale, with an increase rate exceeding that of 2007 by 11%.

As to the chemical sector, developed by Anwil SA, we focused on maximisation of fertiliser product sales, at the same time improving the efficiency of processing line in this particular sector. We also modernised production lines in the PVC complex and built an oxygen generating unit.

Last year, our petrochemical sector tackled with the most difficult economic conditions. A drop in margins and volumes, unstable oil prices and unfavourable currency relations caused a breakdown on the world plastics market at the turn of the 3rd and 4th quarter. In a very short period of time, petrochemical product quotations showed record price drops – even by 60%, and limitations in petrochemicals processing (due to reduced loads or temporary shut-down of installations) inevitably affected sales volumes in the 4th quarter, both in terms of quantity and quality. Due to such difficult conditions, the sector reported lower production and sales volume compared to 2007. Last year, companies in the petrochemical sector continued their flagship investment projects – Unipetrol Group built a benzene and C5 fraction extraction installation, whereas domestically, paraxylene (PX) and purified terephthalic acid (PTA) installations were being built.

Moreover, the Capital Group implemented two significant projects. Last year, ORLEN Gaz finalised the most important of its investment projects – LPG sea terminal in Szczecin – the second largest terminal of the kind in Poland, unique in terms of technological solutions applied. The start-up of the terminal will facilitate handling of deliveries from any possible direction, reduce sensitivity to seasonal price fluctuations and enable diversification of liquefied gas supply sources.
Moreover, in November, ORLEN Eko started up the most modern thermal waste processing plant in Poland. This plant may process not only waste generated within ORLEN Group, but also from external entities.

Bearing in mind the forthcoming changes on the global and domestic market, in the second half of the previous year, we focused on developing the Capital Group strategy, corresponding to the current situation and proposing, in our opinion the most appropriate operational solutions.

Our main objective is to strengthen the Group core business through a long-term change process towards increasing the efficiency of our assets by means of restructurisation, cost optimisation, reasonable investments and improved cooperation between respective sectors. We believe the refinery, petrochemical and retail sectors to be the foundations of our development. The refinery sector will focus on increasing the production of medium distillates and effective compliance with EU requirements in the field of sulphur-free diesel fuels.

The retail sector will continue modernisation and optimisation of fuel station networks, extension of non-fuel offer and reduction of operating costs.

Investment projects in the petrochemical sector include construction of paraxylene (PX) plant in Płock, purified terephthalic acid (PTA) plant in Włocławek, and modernisation and extension of chemical units in Anwil. In Mažeikiu Nafta, we will proceed with the construction of propylene fractionation unit.

We are also planning to continue the development of the exploration and production sector. In the E&P sector, we explore the Baltic shelf and analyse the possibilities of exploiting deposits available in Poland. We are also working on the possibilities of acquisition, as well as entering into relations with potential strategic partners.

In the future, we are also planning to develop the electric energy sector using the available assets and technologies. We will present our strategy for this particular area over the next few months.

Due to dynamic development over the last years in the field of acquisition and investment projects, we reported increased debt level. Thus, considering the progressing crisis, our priority in early 2009 was to secure the Group long-term financing. Meanwhile, tough economic conditions force us to accelerate activities which improve our efficiency, reduce our costs and optimise our investment expenditure. We also continue efforts to sell our assets in the telecommunications and chemicals sector – Polkomtel and Anwil. Those transactions are well into preparation stage, and their finalisation depends on financial capacities of potential buyers.

We are aware that the current year is of crucial importance for the development of the company and the entire Group. We are prepared for various scenarios and we will effectively react to whichever of them happens to be true, bearing in mind the long-term increase in the Capital Group goodwill. I believe that, despite the adverse circumstances, we will manage to achieve our plans and objectives to the advantage of the Company, its Shareholders, Employees and Customers.

I would like to thank all Shareholders for their trust, and Members of the Supervisory Board for their huge contribution to the achievement of our operating and strategic objectives. I believe that our cooperation and constructive dialogue will continue to the satisfaction of the Capital Group and all Stakeholders.

Jacek Krawiec

President of the Management Board
PKN ORLEN S.A.